

04/06/2003 Entry: "Has NAFTA Been a Good Deal for the Average Worker in the United States?"

Has NAFTA been a good deal for the average worker in the United States?;
NO: The trade deficit caused by NAFTA has slowed the economy, resulting in the loss of hundreds of thousands of U

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In the days following the terrorist attacks of Sept. 11, 2001, security at U.S. borders was increased. American factories across the country suddenly were contemplating shutting down because the flow of parts and components from plants in Mexico was slowing to a trickle. Without the production capacity that had shifted to Mexico following passage of the North American Free Trade Agreement [NAFTA], large blocks of the U.S. manufacturing sector were paralyzed. Luckily, corporate protests to the White House put cross-border trade back on a more "business-as-usual" basis.

Most of the debate about NAFTA has focused on the direct loss of American jobs as Mexican laborers earning less than \$2 an hour replace American workers making five or six times as much, plus health and pension benefits. Though there are specific trade disputes with Canada, the United States' NAFTA partnership to the north does not receive the same kind of fundamental criticism. Income and living conditions are similar in Canada, which puts trade on a more level playing field. Every week new evidence of problems with Mexico is reported in local newspapers across the United States. For example, it wasn't a very merry Christmas for the 1,177 employees who were laid off from the LG. Philips Displays plant in Ottawa, Ohio, just before the holidays. Nancy Morman, who had worked at the plant for 32 years, lost more than her paycheck. She will lose two-thirds of her retirement package because at age 50 she is too young to qualify for full retirement. This is a reminder that it is not just lower wages in Mexico but the desire to avoid paying pension benefits that make a movement south of the border attractive to parsimonious firms.

Is this really what economists mean when they talk of comparative advantage as a good thing? In theory, comparative advantage has a country concentrating its resources in those sectors in which it is most productive, then trading some of the output for imports of goods that other countries are better at producing. Trade with underdeveloped countries, however, often is determined by low-cost production stemming from conditions that generally are considered to be negative, such as a desperate and impoverished workforce, corrupt officials and lax regulations governing everything from worker safety to environmental quality.

The great success of America has been the elevation of the industrial "working class" into middle-income status. It is a triumph that has given the United States an unprecedented record of social and political stability as well as economic pre-

eminence. But it is being challenged by a globalization process that sees America's success as a point of commercial vulnerability to be attacked.

The aggregate impact of hundreds of cases such as that of LG. Philips Displays is measured by the trade deficit with Mexico, which has exploded since NAFTA was implemented. In 1993, the United States ran a small \$1.8 billion trade surplus with Mexico. That the U.S. trade surplus with its southern neighbor had been falling in recent years was used by NAFTA proponents to argue that reducing Mexico's trade barriers would put the U.S. surplus back on an upward course.

One of the most famous predictions was made by Gary Hufbauer of the Institute for International Economics, a well-financed "free-trade" think tank. Hufbauer claimed that "NAFTA will generate a \$7 billion to \$9 billion surplus that would ensure the net creation of 170,000 jobs in the U.S. economy the first year." This did not happen, of course, and as the Wall Street Journal reported in its Oct. 26, 1995, edition, "Gary Hufbauer ... whose predictions of NAFTA job gains were embraced by the Clinton and Bush White Houses, now figures the surging trade deficit with Mexico has cost the U.S. 225,000 jobs."

One should not really talk about jobs in such a context, but job opportunities. Under normal circumstances, subject to the vagaries of the business cycle and to external shocks, a developed economy such as that of the United States will tend toward full employment. That means the U.S. economy creates around 2 million jobs a year, as people have to work at something to make a living.

The adjustment mechanism is the wage rate. At what wage level will the labor market clear? One would think that given the almost magical progress made in technology in recent decades, and the cooling of inflation, real wages would be on the rise. Alas, this has not been the case.

According to the 2002-2003 edition of *The State of Working America* by Lawrence Mishel, Jared Bernstein and Heather Boushey, real wages in 2001 were lower than they had been in 1979. This is due to two main factors: the change in the composition of the workforce as high-paying manufacturing employment fell as a share of labor relative to lower-paying services, and the chilling effect on wage increases in domestic manufacturing due to foreign competition.

On the surface, American manufacturing seems to be thriving. From 1987 to 2000, productivity for the manufacturing sector rose nearly 60 percent - but output rose only by about 40 percent, indicating that the sector overall was shrinking. The motor-vehicle and parts industry boosted its productivity by 37 or 44 percent between 1987 and 2000, depending on whether productivity is measured on a per-worker or per-hour basis. But again, output increased by less

than the productivity gain as foreign imports of cars and parts increased, a process in which Mexico played a role.

Americans still have a hunger for manufactured goods. The country is becoming service-oriented only in employment, not consumption. Unfortunately, it is foreign firms and overseas workers who increasingly are supplying U.S. demands in the most productive and lucrative industries. As my colleague at the U.S. Business and Industry Council, Alan Tonelson, has shown, from 1997 to 2000 virtually no American industries gained domestic market share from foreign competitors despite their impressive gains in productivity.

In 2000, the United States imported more than \$1 trillion worth of manufactured goods, including \$196 billion in cars and auto parts, and \$347 billion in capital goods and equipment. The result was a \$452 billion trade deficit in goods, the measure of the net loss to the United States in industrial capacity and job opportunities. The trade numbers only have gotten worse since, and the U.S. goods deficit easily will surpass \$500 billion for 2002.

Federal Reserve Board Chairman Alan Greenspan has called the trade deficit "unsustainable." Both the International Monetary Fund and the 17-nation Organization for Economic Cooperation and Development warned this fall that the U.S. trade deficit poses a danger to the stability of the world economy because of the financial strain it puts on the dollar. The usual "market solution" to such an imbalance is a currency collapse and a deep recession.

Every month the Federal Reserve Bank of St. Louis reports the extent to which the trade sector has slowed the American economy. Those who cite only exports as a pro-growth factor are misleading the public in the same way a sportscaster would be if he reported only the number of points scored by the home team. A football team might feel proud of scoring 27 points, but if the opposing team scores 43, it's still a loser.

According to the 2002 Economic Report of the President, "In 2000 net exports depressed real GDP [gross domestic product] by 0.8 percentage points." The domestic economy was strong enough in 2000 to overcome the negative impact of the trade deficit and still grow, but it would have done better if trade had been balanced, and perhaps avoided the recession.

The \$24.6 billion U.S. trade deficit with Mexico in 2000 was not the main cause of the overall deficit, but it was a contributing factor and a complete refutation of the prediction that NAFTA would improve the United States' international accounts. In 2000, the U.S. automotive trade deficit with Mexico was \$24 billion. General Motors, Ford, DaimlerChrysler, Delphi Automotive Systems and other leading automakers and parts suppliers [including many non-American] have major operations in Mexico. Other major manufactured exports from Mexico include electronic products and telecommunications equipment.

The Clinton administration made a fundamental mistake in thinking that Mexico was a "big emerging market" that required only reforms to open it to U.S. exports. It confused population with purchasing power. Mexico is a low-income country, burdened by debt and suffering a trade deficit of its own that limits its ability to increase imports for domestic consumption without risking another in a series of financial crises. In such a situation, the only practical way for an American company to sell to Mexican consumers is from factories built inside Mexico. The customers with the most money, however, are the corporations that have set up maquiladoras. Exports to them measure not the expansion of U.S. industry, but its dispersion across the border.

Mexico's trade deficit with the rest of the world indicates another failure of NAFTA. A strong argument made during the NAFTA debate was that American firms needed a low-wage export platform in Mexico to combat Asian rivals - mainly Japan - that were expanding production in Southeast Asia.

But Mexico has remained an export platform directed only at the United States, not at markets in Asia or Europe. Instead, Asian and European firms have set up their own maquiladora plants the better to flood the American market. This is the primary reason Mexico runs a trade deficit. It imports parts and equipment from Japan, South Korea and Germany but does not send exports back to those countries. Instead, the foreign goods are used to produce exports shipped to the United States. In 2000, Mexico sent 91 percent of its exports to the United States, compared with 3 percent to Europe and only 1 percent to Asia.

The American political elite has invested so heavily in NAFTA with Mexico that it cannot admit the deal produced none of the predicted improvements in the U.S. position. Instead, it actually added to the trade problems the country has been experiencing for more than a decade.

Now there is a drive to escalate integration with Mexico, erasing the border as much as possible. Washington feels it must bail out Mexico's financial system but dares not enforce its own immigration laws, lest it cast doubt on the wisdom of this southern strategy. Thus every aspect of U.S. relations with Mexico will continue to deteriorate and impose increasing costs on the American people.

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